OPEN MEETING AGENDA ITEM

ORIGINAL

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March 23, 2011

Arizona Corporation Commission
DOCKETED
MAR 23 2011
DOCKETED BY

Via Hand-Delivery

Commissioner Brenda Burns
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Re: Chaparral City Water Company; Docket No. W-02113A-07-0551

Dear Commissioner Burns:

Enclosed please find the Company's response to your request for more information dated March 8, 2011. We appreciate the opportunity to provide additional information on this matter.

Sincerely,

Norman D. James

Enclosures

cc: Docket Control
Chairman Gary Pierce
Commissioner Paul Newman
Commissioner Sandra D. Kennedy
Commissioner Bob Stump
Steven M. Olea, Director (Utilities Division)
Robin Mitchell, Esq. (Legal Division)
Dan Pozefsky, Esq. (RUCO)

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CHAPARRAL CITY WATER COMPANY: CASE QUESTIONS

1. Please review the attached timeline of the events that form the foundation of the case-at-hand today. Do you agree that the timeline is accurate?

CCWC generally agrees with the case timeline. The Company has supplemented the timeline with additional matters primarily to clarify the timing of certain events. Please see Attachment 1 hereto. Additional comments are indicated below.

a. The rate case(s)

Please see the response to Question 1, above. The primary changes are to note that the new rates approved in Decision No. 68176 (Sept. 30, 2005) were based on plant, expenses and revenues during 2003, and that the new rates approved in Decision No. 71308 (Oct. 21, 2009) were based on plant, expenses and revenues in 2006. Also, while the rates approved in Decision No. 71308 were described as "interim," the Staff investigation, completed in early 2010, determined that the bidding problems in California did not affect the Company.

b. ACC decisions appealed to the courts

Please see the response to Question 1, above.

c. Appeal of the rate case

Please see the response to Question 1, above.

d. Recovery of rate case expense

Please see the response to Question 1, above. CCWC notes that although it requested recovery of $100,000 (an amount supported by Staff and recommended in the ROO), CCWC actually incurred approximately $500,000 in expenses for the appeal and subsequent remand proceeding.

e. ACC decisions on these issues

Please see the response to Question 1, above.

f. The rehearing(s) of ACC decisions

Please see the response to Question 1, above.

2. Providing notice to customers when requesting a re-hearing.

a. Is notice required for a rehearing of a case?

CCWC does not believe notice of rehearing is required unless the Commission specifically orders it, and it was not ordered in this case.

The rate case was duly noticed, in accordance with Arizona law. The rehearing is simply a continuation of the same rate case in the same public docket. Thus, the rehearing was not a new matter in which new or additional relief was requested. Instead, it involved reconsideration of two specific issues that were addressed in the main rate case.

Throughout the rate case, all intervenors have been copied on docketed filings, including the rehearing application. In addition, RUCO, chartered to represent residential ratepayer interests, has been an active participant at every stage.

Moreover, RUCO never asked for notice of the rehearing. RUCO first raised the issue on the day of the hearing. *See* Reporter's Transcript of Proceedings, Rehearing, April 12, 2010 ("RhTr.") at 6-7 (copy attached as Attachment 2). The ALJ stated that she was not aware of rehearing notification to ratepayers as being standard procedure. RhTr. at 7. And RUCO then responded: "We understand that it's not practice, and so we will stay with that." RhTr. at 9 (copy attached as Attachment 2).

Thereafter, RUCO did not raise the issue in its post-hearing briefs, which is contrary to the Hearing Division's general "brief it or waive it" policy. Instead, RUCO waited to see if it would prevail before asking that the rehearing be done over again.

b. How is notice supposed to be executed?

In a rate case, the applicant is directed by the Hearing Division as to the form and timing of customer notice, as well as to the filing of proof of notice. Typically such notice is made by publication in a newspaper and mailings to ratepayers. The form of notice sets forth the process for intervention and directs customers on how to obtain further information on the application.

c. How was notice performed in this case?

CCWC published and mailed the customer notice ordered by the Commission in its July 24, 2008 Procedural Order. Proof was docketed on September 4, 2008. Customers again received notice of the new rates that went into effect on October 15, 2009, and customers will receive another notice of the final rates approved in the rehearing.

3. The allocation of settlement proceeds.

a. Is a 50/50 split a common occurrence?

No. In fact, the treatment of settlement proceeds received by a utility for damage to its plant, equipment or other property is almost never addressed in rate cases. CCWC is aware of only two other dockets where the Commission addressed the proceeds of a settlement.

In Decision No. 58497 (January 14, 1994), the Commission concluded that TEP could retain the entire $40 million cash settlement because it was sharing the benefits of an additional power supply retained under the same settlement with ratepayers. *Id.* at 59-60. The Commission recognized the benefits being received by TEP's ratepayers in the form of the supplementary power supply provided under the settlement agreement as well as the risks TEP undertook in order to secure those benefits for its customers. *Id.*

In Arizona Water's Eastern Group rate case, Decision No. 66849 (March 19, 2004), the Commission adopted RUCO's arguments and ordered cash settlement proceeds shared equally between Arizona Water and its ratepayers. The Commission reasoned that an equal sharing "provides a reasonable balance between the rights and obligations of shareholders and ratepayers and will provide the Company with a sufficient incentive to pursue future litigation or settlement of claims that the Company and its customers may be entitled to receive." Decision No. 66849 at 35.

In its 2007 rate application, CCWC proposed a similar sharing of the proceeds from its settlement with the Fountain Hills Sanitary District based on the Commission's Arizona Water's Eastern Group decision in order to eliminate a dispute over this issue. *See* Direct Testimony of Robert N. Hanford (Sept. 26, 2007) at 9-11.

In short, CCWC can only respond that a sharing of proceeds of settlement has always occurred in the limited number of rate cases in which a settlement that compensated the utility for damage has been at issue. All parties also agree that a gain on the sale of utility assets should be shared. *See, e.g.*, RhTr. at 60-63 (copy attached as Attachment 2).

b. If so, what are the reasons for deviating from the norm?

As stated, sharing of proceeds from settlement appears to be the norm when the issue has actually been raised in a rate case. The Company is not aware of any other case where settlement proceeds were confiscated for the benefit of the customers.

c. What is the harm or benefit to the Company and/or customers if the proceeds are split 50/50?

CCWC is harmed by a 50/50 sharing of settlement proceeds. Under a 50/50 sharing, the Company's rate base, i.e., asset market value, is reduced by half of the settlement amount, effectively negating rate base treatment for the Company's investment in used and useful plant. At the same time, under a sharing policy the Company is denied the right to be compensated for damage to its property. Rather than litigating its right to be fully compensated for damages to its property, however, the Company proposed a 50/50 split in its 2007 rate case to mirror ACC decisions in similar cases and to simplify issues and avoid disputes which would have increased rate case expense and delay needed rate relief. *See* Direct Testimony of Robert N. Hanford (Sept. 26, 2007) at 9-11.

As discussed further below, the Sanitary District contaminated one well that was used by MCO Properties (the former owner of the Company and developer of Fountain Hills) for a the community lake in the 1970s and 1980s, but was never used for general water service to customers, and a second well that provided a small amount of water "for blending" purposes. As a result of the District contaminating the wells, both wells have been permanently shut down.

The Company sought compensation for this damage, and, incurring more than $30,000 of legal costs, negotiated a settlement of $1.52 million. Under a 50/50 sharing of that settlement, as CCWC proposed, Staff recommended, and the ALJ has twice recommended, ratepayers benefit through a reduction of rate base and lower rates. Moreover, ratepayers are not required to reimburse the Company for its legal costs, so on a net basis the ratepayers actually retain more than half of the financial benefit.

d. How is the Company harmed if the customers keep 100% of the proceeds?

The Company is harmed by having the full amount of the settlement deducted from its rate base, effectively denying the Company the right to earn a return on its plant and property devoted to public service. This would be confiscatory and deny the Company the right to earn a fair return on fair value of its property, in violation of the Arizona Constitution. It would also give the utility nothing in return for property it owns. *See* prior response.

The Company and all utilities are harmed by creating a situation in Arizona that is not found elsewhere: Depreciated assets that are destroyed, by nature or by acts of man, would become an immediate liability to the rest of the Company's rate base. The Commission would be telling utilities to not seek recovery of any damages to their plant because the proceeds would offset non-damaged plant and lower rate base. The

Company maintains that this would be a very poor policy, as the Commission expressly recognized in the Arizona Water Company Eastern Group decision.

e. How are the customers harmed if the Company keeps 100% of the proceeds?

They are not harmed. The customers pay for utility service at rates set by the Commission, which allow the Company to recover its reasonable operating expenses and earn a fair return on the fair value of its utility plant and property devoted to public service. By virtue of paying for service, customers acquire no right, title or interest in the utility's property, and have no right to any settlement proceeds or damages paid to the Company by a third party who damages or destroys the Company's property.

In addition, as a practical matter, there is no evidence that the cost of water service increased due to the loss of Well #8 and Well #9, nor has the quality of the Company's water service been diminished in any manner. Consequently, there is no harm to any customers.

f. How was the 50/50 apportionment arrived at?

i. Are there other percentage splits that are feasible?

ii. If not, why is 50/50 the best possible outcome?

As stated above, the Company proposed a 50/50 sharing of the settlement proceeds to be consistent with the Commission's Arizona Water Company Eastern Group decision. While the Company believes that it is entitled to all of the settlement proceeds as compensation for the damage to its private property, it believed that by splitting the proceeds, and thereby reducing its rate base and lowering its rates, the treatment of the settlement proceeds would not be an issue in the case.

4. Wells #8 and #9.

a. Did Well #8 go into service in 1971? If not, when was Well #8 entered into service?

To the best of the Company's knowledge, Well #8 was used to fill the community's central Fountain Lake and water the adjoining park beginning in 1971 or 1972, when Fountain Hills was initially developed and home sales began. At that time, the Company was owned by MCO Properties, the developer of Fountain Hills. The Company's records from before American States' acquisition of the Company from MCO Properties in 2000 do not provide a certain date.

b. If it has never been committed to potable service, what was the value of Well #8 at the time of the 2005 settlement with FHSD?

The Company does not have an appraisal or similar formal valuation, and the value is uncertain. The federal standard for arsenic limited the well's use as a primary source of supply. However, should it have been needed, the well could have been used for back-up water supply through blending.

c. Were the costs associated with construction of Well #8 recovered through the Company's water rates?

No. The "cost of construction" of an item of plant is not recovered in rates and charges for utility service. Instead, in Arizona, a utility is entitled to recover a fair return on the fair value of its utility plant and property less accumulated depreciation related to that plant. In addition, a utility is entitled to recover, as an operating expense, annual depreciation. With respect to depreciation expense, the Supreme Court has stated:

> Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. In determining reasonable rates for supplying public service, it is proper to include in the operating expenses, that is the cost of producing the service, an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered.[1]

The Supreme Court also has explained that "[c]ustomers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses, or to the capital of the company."[2]

Consequently, utilities do not recover the "cost of construction" in rates and charges for service. Rather, they recover their operating expense (including depreciation) and a fair return on the fair value of their property devoted to public service.

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[1] *Lindheimer v. Illinois Bell Tele. Co.*, 292 U.S. 151, 167 (1934).

[2] *Board of Public Utility Comm'rs v. New York Tel. Co.*, 271 U.S. 23, 32 (1926).

d. Was Well #8 providing income other than through the Company's water rates?

i. If so, by what amount?

Not to the Company's knowledge. It believes that MCO properties, which owned the water company, pumped water from Well #8 as needed for the community lake and park.

e. How was the Well #8 service negatively impacted by FHSD's Aquifer Storage and Recovery well?

Due to Well #8's proximity to the District's new Aquifer Storage and Recovery Well (ASR), treated effluent from the ASR well could have been detected in Well #8, although, as noted, this well was not in operation at the time and was never used for potable water service.

f. When was Well #8 taken out of service?

1996.

g. What component of plant was used to serve as the Well #8 replacement?

There was no replacement for Well #8 because Well #8 was not used to serve customers. Likewise, as discussed above, there is no evidence it ever was used to generate revenue. Instead, Well #8 was used by then-owner, MCO Properties, to provide water to the community lake. Effluent is now used to fill the lake and to water the adjoining park.

h. When was Well #8 fully depreciated?

While it is inappropriate to isolate the accumulated depreciation on a single asset with a group because CCWC uses the asset group method, on an individual asset basis Well #8 (installed in 1972) was fully depreciated by 2002 assuming a 30 year life.

i. How did that affect rate base?

It does not impact rate base. The Company employs the asset group depreciation method. The asset group method is commonly used and accepted in regulatory utility accounting. As stated in the treatise *Accounting for Public Utilities:*

> The group concept has been an integral part of utility depreciation accounting practice for many years. Though the concept is applicable to nonregulated entities, it is not often applied. Nonregulated entities tend to depreciate individual

> property units independently. Under the group concept, no attempt is made to keep track of the depreciation reserve applicable to individual items of property. This does not imply loss of control, but rather is a practical approach for utilities because they possess millions of items of property. [3]

"Asset group" means plant category or account, such as Account 307 – Wells and Springs or 331 – Transmission and Distribution Mains. Under the asset group depreciation method, the Company does not track its depreciation reserve by individual assets. Only when the asset group is fully depreciated does the depreciation cease. When plant is retired under the asset group method it is assumed to be fully depreciated.

In this case, the plant cost retired for Well #8 was $48,329 (the estimated historical cost), and the adjustment to accumulated depreciation was $48,329. In other words, there was a zero impact on rate base because the cost of plant that was removed from plant-in-service was also removed from accumulated depreciation.

i. Was Well #9 entered into service in 1972?

To the best of the Company's knowledge, Well #9 was used for potable supply beginning in 1971, at which time groundwater was CCWC's only source of water. Unfortunately, the Company's records from before American States' acquisition of the Company in 2000 do not provide a certain date.

j. Were the costs associated with construction of Well #9 recovered through the Company's water rates?

No. As explained in response to Question 4(c), above, the "cost of construction" of an item of plant is not recovered in rates and charges for utility service. "Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses, or to the capital of the company."[4] Consequently, utilities do not recover the "cost of construction" in rates and charges for service. Rather, they recover operating expense (including depreciation) and a fair return on their property devoted to public service.

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[3] Deloitte & Touche LLP, *et al.*, *Accounting for Public Utilities* § 6.04 (Mathew-Bender & Co. 2009).

[4] *Board of Public Utility Comm'rs*, 271 U.S. at 32.

k. How was the Well #9 service negatively impacted by FHSD's Aquifer Storage and Recovery well?

Due to Well #9's proximity to the District's new Aquifer Storage and Recovery (ASR) well, effluent from the ASR well could have been detected in Well #9. However, Well #9 had been taken out of service in 2001.

l. If FHSD had drilled a replacement well for Well #9, could base rates have been affected for customers? If yes, how? How could that affect the Company's rate base?

Yes. Drilling and equipping a new well to supply back-up service would have increased the Company's rate base by the cost to construct the well. The cost to construct a replacement well would be much greater than the historic cost to drill and equip Well #9, which was $54,139, based on CCWC's best estimate from a review of historical records available. In current dollars, the cost would be several times greater (or more). Moreover, arsenic treatment would need to be installed as well as a result of the recent change in the standard for arsenic. However, the Company did not need to replace the water, which had previously been used on a limited basis for blending, because surface water is available and is less costly.

m. When was Well #9 taken out of service?

2001.

n. What component of plant was used to serve as the Well #9 replacement?

There is no specific component of plant that can be directly tied to replacing Well #9. As stated, the well was originally constructed in the early 1970s, when Fountain Hills was being developed and only groundwater was available. Over time, the Company developed additional surface water supplies, including Central Arizona Project ("CAP") water, which the Company began to use in the late 1980s. Due to poor hydrology and arsenic, drilling additional wells was not a viable option.

After American States acquired the Company in 2000, and Well #9 was taken out of service, the Company determined that the well did not need to be immediately replaced. However, the Company has continued to invest funds in and construct water supply and treatment facilities to ensure an adequate supply of water for customers. The following table summarizes the changes in the Company's rate base over the past 25 years, reflecting the Company's investment in water infrastructure:

Decision No.	Test Year	Original Cost Rate Base
55340	1984/1985	$2,502,477
57395	1988	$10,960,810
68176	2003	$17,030,765
71308	2006	$21,370,877

o. When was Well #9 fully depreciated?

i. How did that affect rate base?

While it is inappropriate to isolate the accumulated depreciation on a single asset with a group because CCWC uses the asset group method, on an individual asset basis Well #9 (installed in 1973) was fully depreciated by 2003 assuming a 30 year life. It did not impact rate base for the reasons explained above with respect to Well #8 (*see* response to Question 4(h), above).

5. The Company and FHSD entered in a Well Transfer Agreement in 2005.

a. Has FHSD exercised its option in buying the real property upon which Well #8 is located?

No.

b. The Commission used the Pinal Creek Group Settlement (PCG) as a model for how the settlement proceeds were apportioned. How is the PCG case similar or different from the case? And should the PCG guidelines be applied to this case?

While the facts are not precisely the same, the same basic principle recognized by the Commission in Arizona Water's Eastern Group applies. Specifically, the Commission stated: "we find that splitting the cash proceeds of the [settlement] agreement equally provides a reasonable balance between the rights and obligations of shareholders and ratepayers and will provide the Company with a sufficient incentive to pursue future litigation or settlement of claims that the Company and its customers may be entitled to recover." Decision No. 66849 at 35.

CCWC, frankly, believes that, as a matter of law, customers are not entitled to receive compensation through a reduction in the utility's rate base for the damage or destruction of a utility's private property. However, as stated, CCWC has agreed to accept a 50/50 split of the settlement proceeds it recovered. In any case, there is nothing

that would undermine the Commission's previous reasoning and support a different outcome in this case.

As the Commission recognized, as a policy matter, an equal sharing of the settlement provides an incentive for utilities to pursue claims for property damage. They have no legal obligation to do so, and will not do so if the result is that the utility's rate base is lowered by the amount it recovers.

RUCO argues that the Arizona Water case differs because in that case the utility received certain replacement water and in this case the wells are fully depreciated. There are several flaws in this argument. First, what CCWC is entitled to is a rate that recovers its reasonable operating expenses (which include depreciation) and a reasonable return on the fair value of its property. As previously explained, depreciation is part of the cost of service, and customers pay for service, not for plant. Consequently, the depreciated status of the wells is not relevant.

Second, there is no evidence regarding the depreciated status of the wells in the Arizona Water case, nor did the Commission discuss or rely on that factor in Decision No. 66849. Again, the Commission's decision was based on a policy that provides an incentive for utilities to pursue claims, which benefits both the utility and its customers. There is no benefit to the utility if the amount recovered is deducted from rate base to force rates down. In fact, the utility would be penalized for taking the risk and incurring the costs to pursue claims against third parties. This makes no sense for a public policy standpoint and a prudently run business would not take such risk.

Finally, it should also be noted that replacement water was not available to CCWC as it was to Arizona Water, as demonstrated by the unsuccessful efforts to drill a replacement well. Had replacement water been available, as in the Pinal Creek settlement, there would not have been a $1.52 million dollar settlement payment to share; there may have been no payment or a smaller amount. In other words, the amount paid by FHSD reflects the value of two lost wells that were not going to be replaced due to hydrology. In this way, this case differs from both the TEP and Pinal Creek group matters in that the only thing to share is cash.

c. Is there a deadline for when the wells must be sold?

The settlement agreement does not speak to "selling the wells." Instead, the settlement agreement granted the FHSD a 15-year option to purchase the parcel on which Well #8 is located for use as an effluent recharge facility. It also prohibits CCWC from using the wells and requires that both wells be capped in accordance with Department of Water Resources' regulations.

d. If the Company was protecting its property rights by negotiating the FHSD settlement, then why should ratepayers receive any of the proceeds?

As previously stated, as a legal matter, they should not because they actually have no interest in the wells. The property is owned by the utility, not the ratepayers, and the utility takes all the risk by incurring fees and costs in pursuing the claim. If the utility is not successful in settling or obtaining a favorable judgment, the utility will likely bear the sole burden of the effort. This is why the Company has asserted that the Commission's initial decision undermines any incentive for a utility to pursue claims against a third-party.

In this case, however, CCWC took the risk and spent money to protect its property and then opted to adhere to the policy of a recent Commission decision wherein the Commission found that sharing of proceeds was a positive incentive. In seeking to adopt this sharing approach, CCWC had hoped to avoid a dispute over this very issue, as previously explained. Unfortunately, this has not been case.

e. If customers are ultimately billed for improvements to rate base (via rates of return), shouldn't they receive all of the proceeds of a settlement?

No. Customers are not "billed" for "improvements to rate base." Customers are billed for utility service at rates determined by the Commission to be just and reasonable. Customers do not pay for property and obtain no interest in the utility's property by paying the rates for service, as the Supreme Court has made clear:

> Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to the capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property purchased out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock.[5]

This is the fundamental point on which CCWC and RUCO disagree.

As previously explained, depreciation is simply an operating expense, like salaries and wages, insurance, purchased power and water, and repair and maintenance costs,

[5] *Board of Pub. Utility Comm'rs*, 271 U.S. at 32.

which must be recovered to accurately reflect the cost of providing service.[6] A leading treatise on public utility regulation explains:

> The basic purpose of depreciation accounting is to recover through revenues the costs invested in the physical plant that contribute to the production of those revenues. By matching capital recovery with capital consumption, a more accurate measure of the current costs of operation is possible. Stated another way, depreciation accounting is necessary to reimburse those supplying the capital used to purchase the related assets and should properly be charged to customers as a cost of the service they receive. . . . .
>
> It should be noted that the basic purpose of depreciation accounting is not to finance replacements. Even if facilities are *not* to be replaced, depreciation must be charged to operating expenses in order to record the cost of property consumed in providing service, thereby maintaining the integrity of the investment.[7]

In sum, customers had no legal right or interest in the Company's two wells. Thus, to use RUCO's term, the sharing proposed by the Company was a "windfall" for customers, who were and are receiving safe, reliable and adequate water utility service from CCWC at rates set by the Commission.

f. According to RUCO's Reply Brief the settlement stated the following: "CCWC intends to use the Consideration paid by the District, as hereinafter defined to fund projects to improve CCWC's water production, treatment and distribution system."

i. In what ways has the Company funded projects via funds received from FHSD?

Please see responses to Questions 4(g) and 4(n), above.

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[6] *See, e.g., Lindheimer*, 292 U.S. at 167 (quoted above).

[7] Charles F. Phillips, Jr., *The Regulation of Public Utilities: Theory and Practice* 270-71 (Public Utility Reports, Inc. 1993) (italics original).

6. Replacement water.

a. Did the Company intend to use settlement proceeds to obtain replacement water?

The funds were used to fund projects to improve CCWC's water production, treatment and distribution system. As explained, due to poor hydrology and arsenic levels, additional wells were not a viable option.

b. Can the $1.28 million for the extra CAP allocation be considered as budgeted for replacement water or part of the Company's efforts to keep up with growth?

No. CCWC's water supplies are primarily CAP water with a small amount of well water blended in. Therefore, the loss of any well would not lead to the need for replacement water. In fact, as noted above, Well #9 was already out of service for several years when the settlement was reached.

Moreover, as the Commission determined, the additional CAP allocation was a one-time, take it or leave it opportunity to increase CCWC's renewal water supplies for the long-term benefit of the Company and its customers. Decision No. 71308 at 9-16. Consequently, the Commission determined that CCWC acted prudently in obtaining additional renewable surface water. As further reflected by the Commission's adoption of Staff's recommended 50% of the annual O&M costs for the extra allocation, not all of the water will necessarily be used in a given year. *Id.* at 23-25.

7. Is there anything else that should be addressed?

During the Open Meeting in February, counsel for the Company answered a question by Commissioner Burns regarding the value of the wells. In answering that the wells no longer have value, Mr. Shapiro was speaking in terms of current value as a source of water supply. However, the parcels of land on which the wells are located have a value because the land could be used for another purpose. For this reason, it is possible that the parcels could be sold to another party in the future. If that occurs, CCWC has agreed to share the proceeds of the sale 50/50 with customers.

ATTACHMENT 1

CHAPARRAL CITY WATER COMPANY: CASE TIMELINE

Decision #66849 (Docket No. W-01445A-02-0619)

i. Docketed March 19, 2004.

ii. **Arizona Water Company rate case**

iii. Pinal Creek Group Settlement.

iv. PCG settled with Arizona Water Company for $1.4 million.

v. Staff argued "ratepayers are entitled to entirety of the PCG Settlement proceeds."

vi. RUCO argued "settlement proceeds should be shared equally between ratepayers and shareholders."

vii. The ACC agreed with RUCO that the proceeds should be split evenly.

a. The ACC said "splitting the cash proceeds of the agreement equally provides a reasonable balance between the rights and obligations of the shareholders and ratepayers and will provide the Company with a sufficient incentive to pursue further litigation or settlement of claims that the Company and its customers may be entitled to receive."

Decision #68176 (Docket No. W-02113A-05-0178)

CCWC's Application filed on August 24, 2004 based on 2003 Test Year

1. Docketed September 30, 2005.

2. **Chaparral City Water Company rate case**

3. Appealed to the Arizona Court of Appeals.

4. Memorandum Decision issued on February 13, 2007.

a. The Arizona Court of Appeals held that the ACC erred when it set rates based on original cost instead of fair value.

b. Case was remanded back to the ACC.

Decision #70441 (Docket No. W-02113A-05-0178)

1. Docketed July 28, 2008.

2. **Decision on Remand from Court of Appeals**

a. The decision discussed the various ways the ACC is able to determine fair value.

b. The decision asked "should the Commission authorize the recovery of rate case expense the Company asserts it has incurred as a result of its appeal from Decision #68176 and this Remand proceeding?"

i. The decision said Chaparral may seek to recover its appeal costs at the subsequent rate case.

Decision #71308 (Docket No. W-02113A-07-0551)

CCWC's Application filed on September 26, 2007 based on 2006 Test Year.

1. Docketed October 21, 2009.
2. **Chaparral City Water Company rate case**
3. Authorized new rates for the Company.
   a. Rates were interim pending completion of Staff report documenting its review of California PUC investigation of Golden State Water Company.
   b. Staff review completed in early 2010, no impact on CCWC customers found.
4. 100% of settlement proceeds to ratepayers (except for $30,000 in fees).
   a. The ROO recommended that settlement proceeds be split 50/50, based on the recommendations of Staff and CCWC.
   b. Pierce amendment (passed by the Commissioners) said 100% of settlement proceeds shall go to the ratepayers (except for $30,000 in fees).
5. Decision did not allow Company to recover any costs of rate case appeal even though CCWC prevailed.
   a. The ROO recommended that the Company could recover up to $100,000 of its expenses related to the appeal of Decision #68176.
   b. Pierce amendment (passed by the Commissioners) said the Company could not recover any of the legal expenses related to the appeal of Decision #68176.
6. The Commission authorized a re-hearing on the facts of this case.

Decision #71424 (Docket No. W-02113A-07-0551)

1. Issued December 8, 2009.
2. **Chaparral City Water Company rate case**
3. Corrected the rates, due to a calculation error, that were approved in #71308.

ATTACHMENT 2

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-02113A-07-0551
	REHEARING

At: Phoenix, Arizona

Date: April 12, 2010

Filed:

REPORTER'S TRANSCRIPT OF PROCEEDINGS

ARIZONA REPORTING SERVICE, INC.
Court Reporting
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Prepared for:

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MS. WOOD: Good morning, Judge. Michelle Wood on behalf of the Residential Utility Consumer Office, and with me today is Mr. William Rigsby.

ALJ WOLFE: And for Staff?

MS. MITCHELL: Good morning, Judge Wolfe. Robin Mitchell on of behalf of Commission Staff.

ALJ WOLFE: Okay. We will start today by taking public comments, if there is any.

I see that there is no one in the room, so we will skip that one.

Are there any procedural matters that the company -- that the parties need to raise this morning?

MS. WOOD: Your Honor.

ALJ WOLFE: Yes, Ms. Wood.

MS. WOOD: Just a couple things. One was that I spoke to Mr. Shapiro beforehand, and I understand that we are incorporating from the process here, incorporating into the record the exhibits so we don't have to reintroduce those exhibits as part of this record; is that correct?

ALJ WOLFE: That would be my understanding.

MS. WOOD: Okay. Just making sure. I didn't want to have to copy and kill a tree by replicating what was already in.

And then the second one is -- I asked Robin

beforehand because I haven't done a remand before -- does the Commission notify ratepayers of a rehearing proceeding or how is that normally handled?

ALJ WOLFE: No, not that I know of.

MS. WOOD: Okay.

ALJ WOLFE: The people who were parties to the proceeding have notice of it because they are on the service list.

MS. WOOD: Okay. Thank you.

ALJ WOLFE: Okay. I see that there were testimony filed by RUCO, the testimony of William Rigsby, and testimony filed by Staff, the testimony of Elijah Abinah, and that I did not see any testimony filed by the company.

MR. SHAPIRO: No. That's correct, Your Honor. We notified the parties, as we had agreed to a couple days ago, that we would not be filing responsive testimony.

ALJ WOLFE: Okay. Thank you.

And then this would be the time for opening statement.

Does the company wish to make an opening statement?

MR. SHAPIRO: Your Honor, just briefly, the last thing I want to do is incur any more rate case expense in part fighting about past rate case expense than we need

to.

We appreciate very much the Commission rehearing two of the issues that we raised for rehearing. We do believe that the record more than adequately supports the relief sought on those two issues initially. We welcome Staff's support on those two issues, and we are here to answer any questions and to help the Commission make a final decision in this matter -- on these two issues.

ALJ WOLFE: Thank you.

Ms. Wood.

MS. WOOD: Yes, Your Honor, briefly.

Good morning Judge Wolfe. My name is Michelle Wood, and I'm appearing on behalf of the Residential Utility Consumer Office.

RUCO understands the Commission wishes to rehear the issues related to the Fountain Hills Sanitary District settlement proceeds and the issue of rate case expense, and while we understand which issues the Commission wants to rehear, with all due respect to the Commission, RUCO does not understand quite why.

The public record is devoid of any explanation. In this information vacuum RUCO will attempt to participate in the proceeding, but again, we do not have sufficient information as to the bases of the Commission's concerns.

Likewise, RUCO is also unclear as to whether notice of these proceedings has been or whether they should be given to Chaparral's ratepayers. We understand that it's not practice, and so we will stay with that.

With regard to the first issue of treatment of the Fountain Hills Sanitary Distinct proceeds, RUCO urges the Commission to reaffirm its prior decision to allocate 100 percent of the proceeds to the ratepayers. The proceeds of the settlement agreement are, in the opinion of Mr. Hanford, the company's witness, for the equivalent cost of water to replace that amount the wells would have produced over the remainder of their useful life.

According to the company's witness, Mr. Hanford, the wells are fully depreciated. As such, there is no reasonable basis for the shareholders to receive anything more than the expenses incurred in resolving the dispute with Fountain Hills Sanitation District. To provide the shareholders with $1.52 million or any portion thereof for doing the business, which they are legally required to do, is a windfall.

The company's assertion that shareholders will not pursue such claims if they are not allowed to share 50/50 in the proceeds is without merit. If the company and its shareholders are unwilling to pursue legal rights on behalf of ratepayers, then they need to step down and

case were somewhat different because as part of the agreement the company received replacement water and replacement wells, and that wasn't the case here.

Q. Mr. Rigsby, with all due respect, I'm asking you yes or no questions, and we will be here for five days if you can't give yes or no answers. So it's up to you, sir.

Do you agree with the following statement: Payments for service are not contributions to the depreciation or other operating expenses or to capital of the company. By paying bills for services they do not acquire any interest in the property used for their convenience or in the funds of the company?

A. I can't agree with that entirely for the reasons that I have just given you.

Q. So if I told you that was a long-standing decision of the United States Supreme Court, you would feel that you just can't agree with the Supreme Court?

A. Well, then, excuse me. Again, why then do we typically -- why do regulatory commissions typically mandate sharing on sale or loss -- excuse me -- on gain or loss on the sale of assets?

Q. Mr. Rigsby, you only know what this Commission has done; correct?

A. During the Eastern Group case, when I was writing my direct testimony, I was relying on general information

about public utility -- PUCs in general.

Q. Could you point us to any rule of law or requirement that Commission -- the public utility commissions share 50/50 or in some other matter the proceeds of utility-generated gains?

A. No.

Q. And you can't point to a single Arizona Corporation Commission decision where the utility-generated gains were not shared; correct?

MS. WOOD: Objection; relevance.

ALJ WOLFE: Pardon me?

MS. WOOD: My objection is to relevance. He has already testified multiple times that this is not a sale of an asset.

ALJ WOLFE: Overruled.

THE WITNESS: Would you please repeat the question, please?

MR. SHAPIRO: No, but I could ask Kate to read it back.

(Requested portion of the record read.)

THE WITNESS: No.

Q. (BY MR. SHAPIRO) And you called -- this is your term, isn't it, utility-generated gain? That is a term that you have used in your testimony in the past, isn't it?

A. Utility-generated gain? I think I referred to it as a gain or loss on the sale of assets. I don't know that I specifically used utility-generated gain. I don't know that it would be -- I don't know that it would be -- how you would call it a utility-generated gain. It would have to have occurred as part of the sales transaction.

Q. Let me hand you what we will mark as -- I don't know what we will mark this as.

MR. SHAPIRO: How do you want me to mark it, Judge?

ALJ WOLFE: It's a separate proceeding, so you can start with No. 1.

MR. SHAPIRO: Okay. I will call this CCWC-1.

Q. (BY MR. SHAPIRO) Let me hand you what I have marked as CCWC-1, and let me ask you to turn to page 31.

This is, in fact, your direct testimony in the Arizona Eastern Group -- Arizona Water Eastern Group case; right?

A. Yes.

Q. And this is your testimony regarding the settlement at issue in that case; correct?

A. Yes.

Q. Okay. And you state on line 22 that the Commission has historically recognized the priority of sharing utility-generated gains; correct? That is your

term?

A. Yes.

Q. And in that case you are referring to the settlement proceeds received by Arizona Water Company from the Pinal Creek Group as a utility-generated gain; right?

A. All right. I stand corrected.

Q. Therefore, this is also, in this case, a utility-generated gain, isn't it?

A. In this case.

Again, when you were asking me the question, I was trying to think whether or not I had used that term in this particular case. I wasn't thinking back to the Eastern Group proceeding.

Q. Okay. But you used that term in the Eastern Group proceeding, and it applies equally in the Chaparral City proceeding, doesn't it?

A. Yes. And I did cite some cases supporting our position in the Arizona Water case.

Q. Right. That is on page 32 you are referring to?

A. Yes.

Q. And those are, again, all Arizona decisions?

A. Yes.

Q. And those are all Arizona decisions in which the proceeds were shared?

A. Yes.